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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF SECRETARY

EX PARTE OR LATE FILED

The Honorable Reed E. Hundt  
Chairman  
Federal Communications Commission  
1919 M Street  
Washington, DC 20554

Dear Chairman Hundt:

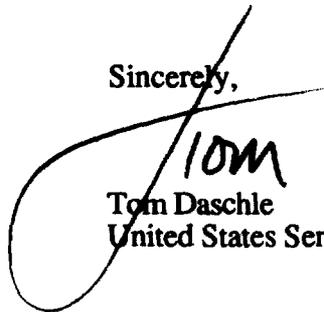
I am writing regarding the status of the Commission's consideration of cable regulations affecting small cable companies. I have enclosed for your information a letter outlining several concerns in this regard from David L. Knudson, a constituent of mine from South Dakota. I believe these concerns merit attention, and I would appreciate your assessment of these issues.

As you know, the 1992 Cable Act passed by Congress directed the Commission to devote special attention to the unique needs of small cable systems during the regulation process. I have appreciated your attention to these concerns in the past, and am confident you will give the issues raised in Mr. Knudson's letter every appropriate consideration.

I look forward to your reply, and thank you for your attention to this important matter.

With best wishes, I am

Sincerely,



Tom Daschle  
United States Senate

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Enclosure

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Honorable Thomas Daschle  
United States Senate  
317 Hart Building  
Washington, D.C. 20510

Re: Situation concerning small cable TV operators

Dear Tom:

I am writing this letter to you on a topic which is of concern to me as a shareholder and officer of a small cable television company in South Dakota, Satellite Cable Services. The FCC's recent rule-making actions with regard to cable television have included some rules which create significant problems for very small systems like ours, and I wanted to draw your attention to these areas of difficulty.

Satellite Cable Services currently serves 9,767 subscribers in 57 communities located in eastern South Dakota. Of these 57 communities, 25 of the cable systems have less than 100 subscribers, and nine of the 57 communities have less than 50 subscribers. Currently Satellite Cable is operating under transitional rules which provide that we do not need to adjust the rates for basic service to the benchmark rates until the FCC develops their "cost of service" program for small cable systems. As you can imagine, we are currently devoting a significant amount of administrative time to these issues, which certainly is expensive and detracts from our efforts to provide quality service to these many small communities. Examples of some of the FCC positions which are disadvantageous to us and other small cable operators are as follows:

1. The current proposed rule-making provides for an administrative fee which cannot be passed on in the rate base to the customer of 37¢ per customer per year to support the FCC rule-making process. This is obviously a significant expense; however, the FCC has provided that each system will be presumed to have at least 1,000 subscribers, and therefore, a minimum fee of \$370.00 per head end or community. In the case of Raymond, South Dakota, Satellite Cable has 28 subscribers, and therefore, the annual fee of \$370.00 comes to \$13.21 per each subscriber, or \$1.10 per month per subscriber.

While there seems to be some sympathy from the FCC to charge this 37¢ on a per subscriber basis (without the 1,000 subscriber minimum assumption), the FCC apparently will not allow it to be passed on in the rate base to the subscriber. Inasmuch as this is an additional cost to the operator, logic would seem to suggest that it be included in the basic rate?

2. In the benchmark calculation under the latest FCC rules, there is an adjuster which allows large Multiple System Operators (MSOs) to have a higher benchmark than small operators. I am sure you will find this amazing, but a large MSO is given about an 80¢ per subscriber advantage in their benchmark rate even though they have significantly lower programming costs and having larger systems are significantly more efficient. The FCC economists have explained that on average before regulation the large MSOs charged higher rates than the rest of the industry, and therefore, they should not be adjusted as far downward as the other folks who have historically charged lower rates. The effect of this is to penalize those small operators which before regulation were providing the best value to the consumer.

3. As a part of the benchmark calculation, the FCC requires that the average income of the community be taken into account in establishing the rate. I question the logic of this because cable programming and other direct costs are not lower than in high income areas. In fact, our programming and operating costs are higher due to our low density of subscribers. The FCC's explanation is that in higher income areas cable rates have tended to be higher, and therefore, there needs to be an increased rate allowance so that the high rates are not required to be lowered too much. In other words, if two operators had identical systems, one charging \$25.00 for the same service, and one \$20.00, each

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system would have to lower their rates some, and if one of the systems was associated with a large MSO they would be able to charge higher rates, and if one showed that there was a higher average income in their community, that community would also have a higher rate. Since there is no relationship to the operator's costs, particularly programming, these just penalize the small low density systems.

4. As I indicated, the small systems are under transition rules, which means we do not need to lower rates until the FCC has finalized their cost of service procedure for determining rates for small systems. However, if after they have made this determination and under their formulas it is determined that our rates are too high, we have the exposure of needing to repay to the consumer the higher amounts which we have been collecting. In this uncertain rate environment, this rebate provision creates a significant hardship on small operators, like Satellite Cable, because our auditors will likely require us to create significant reserves for potential rebate. This will, in turn, create problems for us in complying with the covenants in our loan agreement. I believe all small operators face this problem.

The 1992 Cable Act specifically provided that the unique circumstances of the small cable operator should be taken into account. In their recent rule-making the FCC has ignored the special concerns of the small cable operator and has made it difficult, if not impossible, to provide service to the small communities. The need for administrative paperwork and the administrative fees alone will make it difficult, if not impossible, to provide service. If there can be no relief, then you must know that our company is giving serious consideration to discontinuing service to any communities where we have less than 50 subscribers. It will just no longer make any economic sense.

Our systems face competition from the MMDS (Multipoint-Microwatt Distribution System) operators, who are subsidized by federal grants and low interest REA loans, and also from DBS (Direct Broadcast System), which has recently been launched and will soon be available to our subscribers. In Pierpont, South Dakota, where last week we had 38 subscribers, the MMDS owned and operated by Northern Electric, who, I understand, received a \$500,000.00 federal grant and a low-interest REA loan, installed five large power poles and took six of our customers. We do face significant

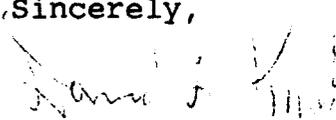
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competition even though the size of our towns is very small. We do not mind competing, but given the federal assistance to MMDS operators, I wonder if we are competing on a level playing field.

We do not have the time nor the staff to complete all of the federal forms, nor at each turn in the road file our position in each FCC rule-making proposal. Many of the associations which have been involved in representing small cable operators have spent significant amounts on legal fees in trying to make the positions of the small cable operators clear to the FCC and are running short of funds because of the numerous changes of position and need to respond.

I would appreciate it if you share these same concerns about small cable television operators that you notify the FCC of your concern and request that in their rules that they take care to understand the particular problems of the small cable television operators. Unless the FCC understands the consequences of their regulations and actions on the smallest of cable television systems, I am fearful that rural areas in South Dakota will see their choices narrowed rather than expanded insofar as they relate to video signals.

Sincerely,



DAVID L. KNUDSON

DLK:kjh

FEDERAL COMMUNICATIONS COMMISSION  
WASHINGTON, D.C. 20554

SEP 30 1994

IN REPLY REFER TO:  
CN9403320

**The Honorable Thomas Daschle  
United States Senate  
317 Hart Senate Office Building  
Washington, DC 20510-4103**

Dear Senator Daschle:

Chairman Hundt has referred to my attention your letter forwarding correspondence from your constituent, David L. Knudson. Mr. Knudson is a shareholder and officer of Satellite Cable Services ("Satellite Cable"), a cable television operator that owns several cable systems in South Dakota. Many of the cable systems owned by Satellite Cable are small systems serving fewer than 1,000 subscribers, in some instances fewer than 50 subscribers. Mr. Knudson believes that certain features of the Federal Communications Commission's rules impose undue burdens on small operators, especially with respect to small systems. As a result, he states, Satellite Cable is seriously considering discontinuing service to communities with fewer than 50 subscribers. You have asked the Commission to consider Mr. Knudson's concerns as we refine our rate regulations.

The Cable Television Consumer Protection and Competition Act of 1992 specifically requires the Commission to "design . . . regulations to reduce the administrative burdens and cost of compliance for cable systems that have 1,000 or fewer subscribers." In promulgating and revising its rate regulations, the Commission has made every effort to fulfill this statutory directive. For example, under our rules small systems that are not affiliated with large operators may avoid the need to engage in complex calculations to develop reasonable rate level justifications, and instead may simply reduce their pre-regulation rates by a flat percentage. Other small systems are permitted to average the necessary financial data on a company-wide basis so that individual calculations are not needed to develop the required "at cost" equipment and installation charges for each franchise area.

The Commission has also acted to ensure that small operators are not required to make unreasonable rate reductions. Specifically, operators that serve 15,000 or fewer subscribers on a company-wide basis are not currently required to reduce their pre-regulation revenues by 17 percent, as most other operators are required to do. Instead, these small operators may retain the rates that they were lawfully charging under our earlier rate regulations, pending the completion of further studies to determine the average costs faced by small operators.

Several of Mr. Knudson's specific concerns have already been addressed by the Commission. For example, Mr. Knudson states that small operators that have not lowered their rates, as permitted under the Commission's transition rules, may become subject to refund liability if it is subsequently determined that their rates are too high. However, no cable operator can become subject to refund liability for charging rates that are permitted under the rules that are in effect at the time those rates are charged. An operator that qualifies for transition relief will incur refund liability only if it incorrectly applies the transition rules, or if the rate that it charged under the Commission's earlier rate regulations, which governs its permitted rate during the transition period, exceeded the permitted rate under those rules. Furthermore, even under these circumstances refund liability on rates charged for basic tier service and equipment is limited to one year in order that cable operators will not find their viability threatened by large contingent liabilities.

Mr. Knudson also states that the Commission's proposed rules implementing cable regulatory fees presumed that each system had at least 1000 subscribers, and therefore would have imposed a minimum fee of \$370 per headend. Since the date of Mr. Knudson's letter, however, the Commission has issued final rules that eliminate this presumption in favor of a flat fee of 37 cents per subscriber. Furthermore, the Commission is actively considering amending its rules so as to permit the regulatory fee to be passed on to subscribers as an external cost.

Mr. Knudson further objects to two factors in the Commission's benchmark formula that he believes unfairly disadvantage certain small systems. First, he objects to a factor that increases the benchmark rate for a system that is owned by a multiple system operator (MSO). Second, he objects to a factor that increases the benchmark rate depending on the average income of a community. The effect of these two factors is that a system which is owned by an MSO and serves a high-income area will calculate a higher benchmark rate than an otherwise similarly situated system, with the same number of subscribers, that is independently owned and serves a low-income area.

The Commission derived the benchmark formula based on data regarding the average rates charged by cable operators before regulation. The theory behind the benchmark is that cable systems with similar characteristics presumably face similar costs. Therefore, the Commission decided that, in the absence of sufficient data regarding actual average costs, cable systems during the transition period would not be required to reduce their rates below the benchmark level for similarly situated systems. This transition rule will remain in effect only until the Commission completes studies of cable systems' actual average costs. Once these studies are completed, percentage rate reductions will be prescribed for different classes of systems based on average cost, and the benchmark will cease to be a factor in setting permitted rates. Because Satellite Cable apparently qualifies for transition relief as a small operator regardless of its benchmark calculation, the benchmark formula should have no effect on Satellite Cable's permitted rates either during the transition period or thereafter.

If the Commission determines through its studies that the factors identified in the benchmark formula do not in fact correlate with higher costs of service, then those systems that qualify for transition relief through operation of the benchmark formula will be required to take the full 17 percent rate reduction required of other operators once the transition period has ended. Similarly, the extent of the rate reduction that will be required of small operators such as Satellite Cable after the transition period ends will depend on the Commission's findings concerning the average costs of small operators. In addition, any cable operator that faces higher than average costs will have the option of justifying higher rates through a cost-of-service showing. In accordance with the statutory directive to reduce administrative burdens on small systems, the Commission has established streamlined cost-of-service procedures for systems that serve 1,000 or fewer subscribers.

Mr. Knudson also notes that some of the systems owned by Satellite Cable face competition from alternative video service providers, including Multichannel Multipoint Distribution Systems (MMDS) and Direct Broadcast Systems (DBS). Under the 1992 Cable Act and the Commission's regulations, cable systems that face effective competition may not be subject to rate regulation. Effective competition exists if, *inter alia*, alternative multichannel video service providers offer service to at least 50 percent of the households in a franchise area and actually serve more than 15 percent of the households in that area. To the extent that any of the franchise areas served by Satellite Cable meet these criteria, the cable systems in those franchise areas are not subject to rate regulation.

Thank you for writing to the Commission about Mr. Knudson's concerns. It is a high priority of the Commission to avoid imposing undue burdens on small systems and small operators, consistent with our obligation to protect the interests of subscribers to all cable systems. We therefore will take Mr. Knudson's concerns into account during our ongoing reconsideration of our rate regulations. To this end, copies of your letter and Mr. Knudson's letter have been placed in the docket in our ratemaking proceeding.

Sincerely,



Meredith J. Jones  
Chief, Cable Services Bureau